

Letter of Findings: 04-20110282
Sales and Use Tax
For Tax Years 2003, 2004, 2005, and 2006

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ISSUE

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-2.5-5-9; IC § 6-2.5-5-27; IC § 6-2.5-5-30; IC § 6-8.1-5-1; IC § 6-8.1-5-4; [45 IAC 2.2-3-7](#); [45 IAC 2.2-3-8](#); [45 IAC 2.2-4-2](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-11](#); [45 IAC 2.2-5-12](#); [45 IAC 2.2-5-16](#); [45 IAC 2.2-5-61](#); [45 IAC 2.2-5-70](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Mynsberge v. Indiana Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Mumma Bros. Drilling Co. v. Department of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc., 338 N.E.2d 698 (Ind. Ct. App. 1976); Indiana Dep't of Revenue v. U. S. Steel Corp., 425 N.E.2d 659 (Ind. Ct. App. 1981); Indiana Dep't of State Revenue v. Harrison Steel Castings Co., 402 N.E.2d 1276 (Ind. Ct. App. 1980); Mechanics Laundry & Supply, Inc. v. Indiana Dep't of State Revenue, 650 N.E.2d 1223 (Ind. Tax Ct. 1995); Carnahan Grain, Inc. v. Indiana Dep't of State Revenue, 828 N.E.2d 465 (Ind. Tax Ct. 2005); Panhandle Eastern Pipeline Co. v. Indiana Dep't. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001); Sales Tax Information Bulletin 12 (December 2002); Webster's II New Riverside University Dictionary (1st ed. 1988); Indiana Department of Environmental Management, Compliance and Pollution Prevention Guidebook for Indiana Printers (2000).

Taxpayer protests the assessment of use tax on purchases of tangible personal property.

STATEMENT OF FACTS

Taxpayer, a printer, operates facilities in Indiana. In addition to traditional printing, Taxpayer also provides additional services, including content creation, digital content management, and distribution, including direct mail and fulfillment.

The Indiana Department of Revenue ("Department") conducted a sales/use tax audit for 2003, 2004, 2005, and 2006 tax years ("Years at Issue") concerning Taxpayer's purchases, including capital assets and expenses. The Department's audit noted that Taxpayer maintains two separate expense capturing systems for its purchases: GEAC expenses and Pcard expenses. "The GEAC expenses are the expenses that typically went through [Taxpayer's] AP system and are payable by vendor invoice. The Pcard expenses included purchases with various credit cards issued to department personnel for use in purchasing materials and supplies for their particular area." (Page 6 to Audit Summary).

Due to the volume of Taxpayer's records, the Department's audit utilized two different approaches in examining Taxpayer's accounts and records to determine Taxpayer's use tax liabilities for the Years at Issue. The audit reviewed Taxpayer's purchases of capital assets separately from its GEAC and Pcard expenses accounts, determining that Taxpayer purchased assets without paying sales tax or remitting use tax. Additionally, the Department utilized a block sample – sample transactions were selected from Taxpayer's records of GEAC and Pcard expenses – and a projection method to determine Taxpayer's tax liability. The Department then assessed Taxpayer use tax on the purchases used in the course of its business activities.

Taxpayer protests the imposition of use tax. Taxpayer states that the proposed assessments overstated its tax liabilities. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales and Use Tax – Imposition.

DISCUSSION

The Department's audit assessed Taxpayer use tax on certain purchases of tangible personal property which were used in the course of Taxpayer's business activities. Taxpayer, to the contrary, claimed that it was not responsible for the use tax based on several reasons: (1) sales tax was paid at the time of the retail transactions; (2) pursuant to IC § 6-2.5-5 et seq., it was entitled to statutory exemptions on certain purchases; (3) certain purchases were "[e]xempt pursuant to [45 IAC 2.2-3-8](#) Construction/Electrical Building"; and (4) certain transaction

was payment for service and, therefore, as a service, it was exempt from sales/use tax pursuant to [45 IAC 2.2-4-2](#).

As a threshold issue, all tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoades v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Id.*; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468–69 (Ind. Tax. Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. *Id.* A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

A. Taxpayer's Supporting Documentation.

The Department's audit noted that a sampling method was utilized and a sample population was selected to compute the proper amount of tax due. However, Taxpayer was not able to produce the necessary source documentation concerning certain selected transactions within the sample population during the audit. As a result, the audit assessed Taxpayer use tax on those purchases because Taxpayer failed to show that sales tax was paid at the time of the purchases.

Taxpayer claimed that the audit erroneously assessed use tax on certain purchases. Taxpayer was not able to provide invoices concerning certain transactions during the audit. At the hearing, Taxpayer submitted additional documentation, including copies of invoices and two Excel Worksheets, one for Pcard Expenses and the other for GEAC Expenses, explaining the basis of its protest. Taxpayer also provided several photos and two video clips demonstrating the operation of the two pieces of equipment, shrink-wrapping system and Buhrs 3000 Filmwrapping system.

1. No Invoices/Supporting Documentation or Invoices Outside of the Selected Sample Transactions.

Taxpayer explained that, on certain transactions at issue, it was not responsible for the use tax because it provided "comparable invoice[s]" or "comparable invoice with an affidavit from the vendor" to support its claim that these purchases were "[e]xempt pursuant to [45 IAC 2.2-5-8](#)." Taxpayer also suggested that it was not responsible for the use tax because the vendors stated that "they can not retrieve [or cannot find] the invoice from their system."

Taxpayer suggests that its documentation is sufficient to support its position that it was not responsible for the use tax. However, the Department is not able to agree. Taxpayer's documentation does not include an "affidavit from the vendor." The only documentation the Department can refer to was vendor's e-mail correspondence with Taxpayer, which is insufficient to support that sales tax was paid or the items at issue were exempt. "Comparable invoices" are not sufficient to show that Taxpayer purchased exactly the same items at issue listed in the audit summary, which was the basis of the proposed assessments. Additionally, Taxpayer's two Excel Worksheets contained inconsistent information, which were not supported by its documentation. An example is further discussed in Part B.1.a.

IC § 6-8.1-5-4(a) requires Taxpayer to keep books and records, which includes "all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks," so that the Department can determine the proper amount of Taxpayer's tax liability. Taxpayer presented invoices from different transactions, which were outside of the sample population. In the absence of the actual source documentation, the Department is not able to agree that Taxpayer has met its burden demonstrating that the assessment was incorrect.

Additionally, Taxpayer referred to IC § 6-8.1-5-1(c), claiming that these purchases were exempt. IC § 6-8.1-5-1(c) states:

If the person has a surety bond guaranteeing payment of the tax for which the proposed assessment is made, the department shall furnish a copy of the proposed assessment to the surety. The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed

assessment is made.

This provision does not offer any statutory exemption. Thus, Taxpayer's reliance on the statute is misplaced. For transactions under this category, Taxpayer's documentation failed to support its protest.

2. Invoices Showing Sales Tax Paid.

During the audit, Taxpayer did not provide certain invoices requested. As a result, the Department assessed use tax because Taxpayer was not able to demonstrate that it paid sales tax at the time of the purchases. At the hearing, Taxpayer asserted that it had found the invoices requested, which showed that it has paid sales tax at the time of its purchases and therefore it was not responsible for the use tax.

Pursuant to IC § 6-2.5-3-4(a)(1), "the storage, use, and consumption of tangible personal property in Indiana is exempt from the use tax if [] the property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property." Taxpayer's documentation demonstrates that it paid sales tax on the following transactions.

Audit Page	Date	Amount
95	07/27/2004	\$164.42
95	07/20/2004	\$ 12.33
97	04/11/2005	\$291.78
97	04/19/2005	\$ 58.26
97	04/22/2005	\$ 70.91
98	04/01/2005	\$318.00
102	07/28/2004	\$ 25.42
102	07/14/2004	\$ 19.83
103	04/19/2005	\$928.23
103	04/19/2005	\$ 51.05
104	06/13/2006	\$455.17
107	04/18/2005	\$351.26
107	04/08/2005	\$121.97

Thus, Taxpayer has provided sufficient documentation to show that sales tax was paid on the above 13 purchases. Therefore, Taxpayer was not responsible for the use tax. Taxpayer's protest of the 13 items is sustained.

B. Taxpayer's Claimed Manufacturing Exemptions.

The Department's audit assessed use tax on certain items Taxpayer used in its business activities. The Department's audit noted that Taxpayer's production takes place in several steps: printing, assembly, binding, and finishing. Taxpayer first uses forklift trucks (or clamp trucks) to move large rolls/sheets of paper (raw materials), which are stored in a separate area, to the printing press area. Taxpayer then uses hoists or cranes to lift the paper rolls/sheets onto a spindle at the front of each of the printing presses. Once the rolls/sheets of paper are loaded, the paper is then fed into the press to begin the printing process. The printed materials then undergo cutting and trimming. After that, the printed materials are folded into multiple pages which become a section of books (magazines or catalogs), known as "signatures" or "sigs." From there, Taxpayer moves those signatures to assembly. At this step, Taxpayer assembles multiple signatures (sometimes also includes non-printed materials) into proper order. Then, Taxpayer proceeds to binding, where it combines all materials using either a sewing technique or applying glue to ensure all assembled materials stay together. At this step, Taxpayer also uses rolls of paper to make jackets (or covers) for books, magazines, or catalogs, if required. Once the binding is completed, Taxpayer offers its customers options of embossing, folding, gilding, laminating, ribboning, or shape cutting the printed materials; or inserting materials in to the printed items. Sometimes, books (or equivalents) are individually packaged at this finishing step.

The Department's audit further noted that Taxpayer offers its customers "direct-mail" or "fulfillment" services. These services include printing or applying stickers (or labels) to the printed materials; inserting advertisement; directly mailing the finished products to the recipients/consumers designated by its customers.

Taxpayer claims that it was entitled to manufacturing exemptions on its purchases of tangible personal property, such as air filters, balers, motors, lamps, lights, ink pumps, salt, packaging conveyor belts, labels, videojet equipment, accessories, and repair or replacement parts. Additionally, Taxpayer asserts that the Department's audit only allowed a 50 percent exemption on certain forklifts (or trailers), including propane, fuel, and repair/replacement parts where Taxpayer believed that it was entitled to an estimated 83 to 88 percent exemption on the use of these items. Taxpayer believes that its production ends after all merchandise is palletized and ready to be shipped to its customers or to be delivered to the USPS Post Office to be mailed to consumers.

As mentioned above, Taxpayer bears the "burden of proving that the proposed assessment is wrong." IC § 6-8.1-5-1(c); Lafayette Square Amoco, 867 N.E.2d at 292.

Generally, all purchases of tangible personal property by persons engaged in the direct production,

manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 100-101. Thus, in applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). The exemptions to which Taxpayer aspires like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Indiana Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Therefore, in order for Taxpayer to prevail on the different issues it raises, Taxpayer must demonstrate that the initial assessment was "wrong" and that it is instead entitled to a sales tax exemption which is "strictly construed" in favor of taxation.

IC § 6-2.5-5-3, in relevant part, provides:

(a) For purposes of this section:

...

(2) commercial printing shall be treated as the production and manufacture of tangible personal property. (b) Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it **for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. (Emphasis added).**

IC § 6-2.5-5-1(b) provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it **for direct consumption as a material to be consumed in the direct production of other tangible personal property** in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. **(Emphasis added).**

Thus, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture... of other tangible personal property." In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. "Fairly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Indiana Dep't of State Revenue*, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. *General Motors Corp. v. Indiana Dep't. of State Revenue*, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991). The application of Indiana's double-direct manufacturing exemptions often varies based on a determination of when a taxpayer's manufacturing process is considered to have begun and ended.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment are directly used in the direct production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. *Id.* An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#), example 1.

[45 IAC 2.2-5-8\(k\)](#) describes direct production as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired, and that the change must be substantial resulting in a transformation of the property into a different and distinct product.

The exemption for direct use in production is further explained at [45 IAC 2.2-5-11](#), in part, as follows:

(a) The state gross retail tax shall not apply to sales of tangible personal property to be directly used by the purchaser in the direct production or manufacture of any manufacturing or agricultural machinery, tools, and equipment described in [IC 6-2.5-5-2](#) or 6-2.5-5-3 [[IC 6-2.5-5-3](#)].

(b) The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to tangible personal property directly used in the direct production of manufacturing or agricultural machinery, tools, and equipment to be used by such manufacturer or producer.

(c) The state gross retail tax shall not apply to purchases of tangible personal property to be directly used by the purchaser in the production or manufacturing process of any manufacturing or agricultural machinery, tools, or equipment, provided that the machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect upon the article being produced or manufactured. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated

process which produces tangible personal property.

(d) For the application of the rules [subsections] above, refer to Regs. 6-2.5-5-3 [[45 IAC 2.2-5-8](#) through [45 IAC 2.2-5-10](#)] with respect to tangible personal property used directly in the following activities: pre-production and post-production activities; storage; transportation; tangible personal property which has an immediate effect upon the article produced; maintenance and replacement; testing and inspection; and managerial, sales, and other nonoperational activities.

The exemption for direct consumption in production is further explained at [45 IAC 2.2-5-12](#), in part, as follows:

(a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.

(b) The exemption provided by this regulation [[45 IAC 2.2](#)] applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.

(c) The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; i.e., they have an immediate effect on the article being produced. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

[45 IAC 2.2-5-8](#)(d) states:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

[45 IAC 2.2-5-8](#)(f) provides:

(1) Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable.

(2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.

(3) Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

(4) Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

[45 IAC 2.2-5-8](#)(g) further states:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit.

The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property. (Emphasis added).

Additionally, [45 IAC 2.2-5-8](#) (j) provides:

Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax.

This category includes, but is not limited to, tangible personal property used in any of the following activities: **management and administration**; selling and marketing; exhibition of manufactured or processed products; **safety or fire prevention equipment which does not have an immediate effect on the product**; space heating; **ventilation and cooling for general temperature control**; **illumination**; heating equipment for general temperature control; and **shipping and loading. (Emphasis added).**

In RCA Corp., the taxpayer, RCA Corp., claimed that it purchased certain environmental control equipment, i.e., air conditioning equipment, to be directly used in the direct production of color television picture tubes, and, therefore, was exempt from sales/use tax. RCA Corp., 310 N.E.2d at 97-98. In making its case, RCA Corp. argued that the environmental control equipment was "used to control the temperature, humidity and presence of foreign particles in the air, in around and on the surface [sic] of color television picture tubes during the manufacturing process." Id. The trial court agreed with the RCA Corp., but the Indiana Court of Appeals ("RCA Court") disagreed. Reversing the trial court's decision, the RCA Court ruled in favor of the Department. Applying the "double direct standard," the RCA Court found that:

Whatever effect (whether positive or negative) that RCA's air conditioning or environmental control equipment may have on the tubes RCA manufactures, or on the process of their manufacture, is exerted through the

medium or agency of the environment (i.e., the air). The very name of the equipment, whether 'air conditioning' or 'environmental control', signifies that its immediate effect is on the surroundings in which the manufacturing process takes place and only remotely, through the intervening agency of those surroundings, on the tubes or on the process by which they are manufactured. Id. at 100.

The RCA Court thus determined that RCA Corp. was not entitled to the manufacturing exemption for its purchase of the environmental control equipment/air conditioning equipment.

The Indiana Court of Appeals subsequently addressed a similar issue, but on a very different set of circumstances, in *Indiana Dep't of State Revenue v. Kimball Int'l, Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988). In *Kimball*, the taxpayer, Kimball International, manufactured "finished wood products and components, including pianos, speaker cabinets and furniture." Id. at 455. Kimball International claimed that it was entitled to the manufacturing exemption on its purchases of "spray booths, air make up units, and their associated component parts." Id. Ruling in favor of Kimball International, the Indiana Court of Appeals ("Kimball Court") explained, in pertinent part, that:

The spray booth and air make up units come into play during the final phase of the manufacturing process, when the finish is applied. After the wood products are assembled and prepared, they are moved by conveyor into finishing rooms. The finishing rooms are isolated from the rest of each plant by separate walls and positive air pressure. The spray booths and air make up units are found inside the finishing rooms. The spray booths are three-sided structures and also include fans, water baths and duct work. The spray booths are designed so that overspray and evaporated solvents are exhausted from the finishing rooms through the water baths and duct work to the outside.

The air is exhausted from the finishing rooms at a rate of 120,000 cubic feet per minute, thus creating a need for an air in-take system. This is the function of the air make up units which include fans, filters, heaters and duct work. In addition to bringing in outside air, the air make up units heat the air and control its humidity. Id.

The Kimball Court, through expert testimony and exhibits, found that Kimball International used the spray booths and air make up units to prevent a "blushing" condition in the manufacturing process so its finished products can be "saleable." Id. The Kimball Court also found, in relevant part, that:

It was undisputed that collecting and removing the excess spray by use of the spray booths, spray booth coatings, water baths, and paint deflocculents is critical from a safety standpoint. The chemicals Kimball uses are highly flammable and without constant cleansing, the air in the finishing rooms would quickly become explosive.

It was also uncontroverted that the combination of the air make up units and the spray booths creates an airflow that is essential to the manufacturing process. This air movement promotes drying of the newly applied finish. Without this predrying a condition called "blistering" would occur during the later oven drying stage whereby trapped solvents would create bubbles in the finish. The airflow is also responsible for controlling sags and runs in the newly applied finish by improving the uniformity of the spray. Id.

The Kimball Court thus concluded that Kimball International met its burden of proof and was entitled to the manufacturing exemption on its purchases of spray booths, air make up units, and the associated component parts.

Based on Taxpayer's supporting documentation and the Department's audit, this Letter of Findings concludes that Taxpayer's production begins, after the rolls of paper are loaded, when the rolls of paper are fed into the press to start the printing run with the application of ink. Taxpayer's production ends when the printed materials become books, magazines, or catalogs. At this point, the printed materials – namely books, magazines, or catalogs – become finished products–saleable goods, which include CDs or similar materials individually packaged to be incorporated into the books/printed products, if required. This Letter of Findings addresses each of Taxpayer's arguments as follows:

1. Items Claimed to be Directly Used in Direct Production.

The Department's audit assessed Taxpayer use tax on certain items on the ground that Taxpayer did not directly use them in its direct production. The auditor determined that a list of items, including air filters, balers, motors, lamps, lights, paster tabs, ink pumps, salt for boilers, packaging conveyor belts, banding machines, labels, videojet equipment, accessories, and repair or replacement parts (including shipping charges), as well as cleaning compounds, were used in pre-production, post-production, or non-production, based on Taxpayer's records and its explanation as well as the auditor's in-person tour at Taxpayer's facility. Taxpayer, to the contrary, claimed that the items at issue were directly used in its direct production, and, therefore, it was entitled to the manufacturing exemptions outlined in IC § 6-2.5-5-3 and [45 IAC 2.2-5-8](#). Taxpayer also asserted that it estimated that it was entitled to between 83 and 88 percent exemption on certain purchases (leases) related to trailers, forklifts, including propane, fuel, and repair/replacement parts, but the Department's audit only allowed 50 percent.

a. Tangible Personal Property Only Supported by Invoices.

Taxpayer claimed its purchases of tangible personal property, such as air filters, blades, tools, or lamps, were

directly used in its production. Thus, it argued that it was entitled to the manufacturing exemption pursuant to IC § 6-2.5-5-3 and [45 IAC 2.2-5-8](#).

Taxpayer is reminded that it bears the burden of proof, demonstrating that the assessment is wrong. IC § 6-8.1-5-1(c). Taxpayer's documentation simply stated that the items were exempt pursuant to IC § 6-2.5-5-3 or [45 IAC 2.2-5-8](#) and directed the Department to review copies of the invoices. For example, Taxpayer asserted that it purchased "air filters" to be "used on building air handlers" or to be "used inside plant to filter air before it gets to people and equipment on the HVAC makeup air fans." It thus claimed that its purchases of the "air filters" (Pcard #2, 265, 266, 267, 268, 269, 270, 271, 272) were "[e]xempt pursuant to [45 IAC 2.2-5-8](#) Repair Part – Air filters used on manufacturing equipment." Taxpayer's invoices could be helpful in determining what it had purchased concerning the specifically selected transactions; however, the invoices alone are insufficient to demonstrate that the tangible personal property at issue was indeed directly used in the directly production as Taxpayer claimed. Specifically, Taxpayer asks that the Hearing Officer second-guess the determination of the auditor who had the advantage of visiting Taxpayer's manufacturing facility, touring the production process, hearing an explanation of that process directly from Taxpayer's personnel, and witnessing first-hand the manner in which the items at issue were used. The documentation Taxpayer provided identifies these items but does not demonstrate their use. Given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer was entitled to manufacturing exemptions based on the invoices alone. Thus, Taxpayer's protest related to items in this category is respectfully denied.

b. Forklifts, Trailers, Propane, Fuel, Accessories and Repair/Replacement Parts.

Taxpayer estimated that it was entitled to between 83 - 88 percent exemption on certain purchases related to trailers, forklifts, propane, fuel, accessories and repair/replacement parts, which it determined to be used in moving "work-in-progress" products or in its production. The Department's audit noted that Taxpayer did not conduct any study to determine the actual taxable/exempt use of its forklifts. The audit also noted that:

[T]he forklifts are used in both pre- and post-production activities, as well as exempt production activities for all plant locations. From the plant tours and discussions with the plant personnel, the auditor has determined that the usage of the forklifts and related parts would be taxable 50 [percent] of the time and exempt 50 [percent] of the time. It was determined that 50 [percent] of the forklift's use was spent on production activities. These activities included moving work-in-process between the production lines. It was determined that 50 [percent] of the forklift's use was spent on pre and post-production activities. These activities included moving raw materials to the production line and moving finished goods within the plant.

Taxpayer, referring to its controller's estimates and his affidavit, asks that the Hearing Officer second-guess the determination of the auditor who had the advantage of visiting Taxpayer's manufacturing facility, touring the production process, hearing an explanation of that process directly from Taxpayer's personnel, and witnessing first-hand the manner in which the forklift was used. The documentation Taxpayer provided does not overcome this bar.

Taxpayer's protest of items at issue in this category is respectfully denied. Since the audit allowed Taxpayer 50 percent exemption on the use of certain forklifts, Taxpayer remains liable for the 50 percent use tax on the forklifts specifically stated in the audit under this category. Additionally, for the trailers and remaining forklifts, which the audit determined to be used in a nonexempt manner, Taxpayer is responsible for the 100 percent use tax.

c. Software and Equipment.

Taxpayer claimed that it used the software and equipment in direct production to control the presses and, therefore, its purchases of the equipment were not taxable. Referring to a sample copy of a "house bill," Taxpayer further asserted that "[t]he software is not subject to tax" because "[t]he software was internally-developed" and "[t]he charges for software [] are internal charges [that] spread the internal costs of the software development" across various users within the company.

A review of Taxpayer's documentation, however, shows otherwise. Taxpayer's documentation states that it used the software and equipment "to audit and manage the entire print process... [I]t is a comprehensive job management system. All resources are managed by [the software and equipment] – including staffing and raw materials." Additionally, The Department's audit noted that:

The [c]omputers and software programs... were used to record the operator's time, number of sigs produced, errors, monitors raw materials, etc. These are not manufacturing functions because they do not directly affect the product. Rather the recording of an operator's time, the number of parts produced and monitoring raw material (Inventory) are all management functions.... [The software and equipment are] simply used as a means of gathering data to improve the overall productivity of the taxpayer's production process. Machinery used for a managerial function is taxable per [45 IAC 2.2-5-8\(j\)](#). (Page 14 to Audit Summary).

Thus, Taxpayer did not directly use the software and equipment in its direct production; therefore, it was not entitled to the manufacturing exemption.

Presumably, Taxpayer purchased the components of computers, i.e., tangible personal property, from third party retail merchants. But, its "house bill" failed to show sales/use taxes were paid at the time of the purchases. Were the "house bill" intended to evenly allocate the costs within its business enterprise, it also should have

reflected the shared burden of tax to its Indiana facilities when Taxpayer decided to capitalize the items at issue. Taxpayer asks that the Hearing Officer second-guess the determination of the auditor who had the advantage of visiting Taxpayer's manufacturing facility, touring the production process, hearing an explanation of that process directly from Taxpayer's personnel, and witnessing first-hand the manner in which the software and equipment were used. The documentation Taxpayer provided does not overcome this bar. Since Taxpayer did not pay sales tax, use tax is properly imposed. Taxpayer's protest of items in this category is denied.

d. Balers, Conveyors, and Related Parts.

Taxpayer claimed that its purchases of balers, conveyors, and related parts were exempt under IC § 6-2.5-5-3 because it "manufactures a combination of printed product and paper product.... Balers are used to bale paper product, a byproduct of the printing process." Upon reviewing Taxpayer's documentation, the Department is not able to agree that Taxpayer manufactures "paper product." Rather, Taxpayer's use of the baler is in connection with the disposition of the "scrap paper." Taxpayer acknowledged that its paper product is "a byproduct of the printing process." The use of the balers is, therefore, post-production, and its use of the balers is, at best, considered a practical necessity because it is easier to transport the baled scrap paper than scattered paper. Thus, Taxpayer's use of the balers and conveyors is not used in connection with the direct production process of its printed products. Taxpayer's protest of items in this category, including balers, conveyors, and related parts, is respectfully denied.

e. Equipment used in Direct Mail or Fulfillment Services.

Taxpayer further claimed that its purchases of "Videojet equipment," "Inkjet plow," "Gating Hopper and indexing take-away conveyor," "In-line card feeders" and related equipment (including equipment used to apply static charge to paper which allows inserts to be put into catalogs), and replacement parts were exempt under IC § 6-2.5-5-3(b). Taxpayer stated that it used the Videojet equipment "to print address and messages on catalogs before [the catalogs are] sent to customers or the Post Office;" that it used the Inkjet plow "to open up a catalog on the line to allow a printer to print an address or message on the inside of a catalog;" and that it used the "[In-line card] feeders to insert small cards into or onto the main catalog."

Taxpayer's documentation, however, shows otherwise. As mentioned above, Taxpayer offers its customers "direct-mail" or "fulfillment" services. These services include printing or applying stickers (or labels) to the printed materials; inserting advertisement; directly mailing the finished products to the recipients/consumers designated by its customers. These activities take place after the catalogs were produced. Catalogs are the finished products thus ending Taxpayer's exempt production. Given the totality of the circumstances, in the absence of other documentation, the Department is not able to agree that Taxpayer has met its burden to demonstrate that its purchases and use of the equipment in this category is exempt pursuant to IC § 6-2.5-5-3(b).

f. Packaging Equipment.

Taxpayer claimed that its purchases of a "palletizer," a "shrink-wrapping system," "bundling equipment," "conveyors and labeling" equipment, and "high speed strapping machines" were exempt pursuant to [45 IAC 2.2-5-8](#)(d). Specifically, Taxpayer argued that its manufacturing production includes "packaging." [45 IAC 2.2-5-8](#)(d) states:

"Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Example (1) to [45 IAC 2.2-5-8](#)(d) illustrates that "[t]he production of pharmaceutical items... begins with weighing and measuring out appropriate ingredients... and ends with packaging the items." A purchaser/consumer would not have purchased a pharmaceutical item if it were not properly packaged. Therefore, a pharmaceutical item is not saleable if not packaged. Packaging is thus a part of the pharmaceutical production because packaging is required.

In this instance, the Department's audit noted that Taxpayer's production, at the finishing step, includes the "individual packaging of the books" because "[c]ertain books are packaged in individual boxes and may be grouped or assembled with other key components such as CD's and the like. Per audit, packaging of this nature is considered an exempt activity." (Emphasis in original) (Page 5 to Audit Summary, Explanation of Adjustments). The audit further noted that Taxpayer also delivers voluminous "printed materials annually, involving the distribution of magazines, catalogs, direct mail, newspaper inserts and newsstand magazine shipments," which were not manufacturing production activities. Id.

Taxpayer may assert that all of its packaging activities should be exempt because it used the "palletizing, shrink wrapping, bundling, conveyors [and labeling] and related equipment... to package product to be sent to [its] customers" and thus its production included "packaging." However, Taxpayer's documentation failed to demonstrate that its manufacturing process requires "packaging." As mentioned above, Taxpayer's production ends when the printed products become finished products—saleable goods. Taxpayer's use of the items at issue is to secure or protect the printed products during shipment to its customers. Taxpayer's use of these items is not exempt. *Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc.*, 338 N.E.2d 698, 702 (Ind. Ct. App. 1976). "The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required... by practical necessity does not itself mean that the property has an

immediate effect upon the article being produced." (Internal quotation omitted). Thus, Taxpayer's reliance on [45 IAC 2.2-5-8\(d\)](#) is misplaced.

Moreover, sales of wrapping material could be exempt "if the person acquiring the [materials] acquires them for use as nonreturnable packages for selling the contents that he adds." IC § 6-2.5-5-9(d); see also [45 IAC 2.2-5-16](#). However, the machinery, related equipment, and replacement parts to the machinery and related equipment are not exempt pursuant to IC § 6-2.5-5-9(d) and [45 IAC 2.2-5-16](#). Thus, Taxpayer's purchases of packaging equipment, including "palletizer," "shrink-wrapping system," "bundling equipment," "conveyors and labeling," "high speed strapping machines" remain taxable.

In short, for the items at issue under this section, Taxpayer's protest is respectfully denied. Since Taxpayer did not pay sales tax at the time of its purchases, use tax is properly imposed.

2. Items Claimed to be Qualified for Safety Clothing or Equipment.

The Department's audit assessed use tax on Taxpayer's purchases of tangible personal property, including "Overhead crane system for casemaker," "Shoecovers," "Sweatbands," "Pureflow Eyesaline Cartridges," "Ear Muffs, Coveralls," and "Walk Boards" because Taxpayer did not pay sales tax or remit use tax. Taxpayer, to the contrary, claimed that it was entitled to the exemption pursuant to [45 IAC 2.2-5-8\(c\)](#), example (2)(F). Taxpayer also claimed its purchases of "air filters" qualified for this exemption.

[45 IAC 2.2-5-8\(c\)](#) states:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., **they have an immediate effect on the article being produced**. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

--EXAMPLES--

...

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

...

(F) **Safety clothing or equipment which is required to allow a worker to participate in the production process without injury** or to prevent contamination of the product during production. (**Emphasis added**).

In *Indiana Dep't of State Revenue v. U.S. Steel Corp.*, 425 N.E.2d 659 (Ind. Ct. App. 1981), the appellate court affirmed the trial court's findings, in favor of the taxpayer, U.S. Steel Corp., that it was entitled to the manufacturing exemption concerning its purchases of personal protective equipment, including, but not limited to, prescription safety eyeglasses, protective mittens, hardhats, goggles, masks, hoods, jackets and aprons. The U.S. Steel court refined the application of the "double direct standard" illustrated in *Indiana Dep't of State Revenue v. Harrison Steel Casting*, 402 N.E.2d 1276 (Ind. Ct. App. 1980) and focused on "whether the safety equipment is an integral part of manufacturing and operates directly on the product during production."

Acknowledging that the "U.S. Steel's safety equipment was one of the tools used by workers to accomplish the job," The U.S. Steel court concluded that:

Since steel can be made only because shielded workers deal directly with the raw materials of the product, the shields not only protect the worker but are a part of manufacturing which operates directly on the product during production.

U.S. Steel, 425 N.E.2d at 664.

Thus, according to the U.S. Steel court, the taxpayer was entitled to exemption because without the protection of personal protective equipment, including prescription safety eyeglasses, protective mittens, hardhats, goggles, masks, hoods, jackets and aprons, its workers would not have been able to safely and directly handle the materials used in its production process.

Unlike the workers in U.S. Steel, in this instance, Taxpayer simply claimed that its use of the items at issue were exempt under [45 IAC 2.2-5-8\(c\)](#), example (2)(F). Although Taxpayer's documentation contained some descriptions of tangible personal property it purchased, its documentation failed to demonstrate that without the items at issue, its employees would not have been able to safely and directly handle the materials used in its direct production process. Specifically, the Department's auditor determined that the items at issue were not exempt from sales/use tax after toured Taxpayer's facility and obtained the first-hand knowledge regarding Taxpayer's use of the items. Thus, in the absence of other documentation, the Department is not able to agree that Taxpayer has met its burden of proof demonstrating that its purchases were exempt pursuant to [45 IAC 2.2-5-8\(c\)](#), example (2)(F).

In short, for the items at issue in this section, Taxpayer's protest is respectfully denied. Since Taxpayer did not pay sales tax at the time of its purchases, use tax is properly imposed.

3. Items Claimed to be Qualified for Environmental Quality Compliance.

Taxpayer claimed that its purchases of LEL monitoring systems and certain cleaning compounds, including bleach, were exempt pursuant to IC § 6-2.5-5-30 and [45 IAC 2.2-5-70\(a\)](#). Taxpayer also asserted that its

purchases of air filters qualified for this exemption.

IC § 6-2.5-5-30 provides:

Sales of tangible personal property are exempt from the state gross retail tax if:

- (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure **predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and**
- (2) **the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.**

The portion of the sales price of tangible personal property which is exempt from state gross retail and use taxes under this section equals the product of: (A) the total sales price; multiplied by (B) one hundred percent (100 [percent]). **(Emphasis added).**

[45 IAC 2.2-5-70](#), in relevant part, further states:

- (a) The state gross retail tax does not apply to sales of tangible personal property which constitutes, is **incorporated into**, or is **consumed in the operation** of, a device, facility, or structure **predominately used and acquired for the purpose of complying with any state, local or federal environmental qaulity [sic] statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing**, processing, refining, mining, or agriculture.
- (b) Definitions. (1) **Consumed** as used in this regulation [\[45 IAC 2.2\]](#) means the dissipation or expenditure by combustion, use or application, and does not mean or include the obsolescence, discarding, disuse, depreciation, damage, wear or breakage of tools, machinery, devices or furnishings.
- (2) **Incorporated** as used in this regulation [\[45 IAC 2.2\]](#) means the material must be physically combined into and become a component of the environmental quality device, facility, or structure. The material must constitute [sic] a material or integral part of the finished product. **(Emphasis added).**

The word "comply" is defined as:

1. To act in accord with another request, command, rule, or wish.
2. Obs. To be courteous or obedient.

Webster's II New Riverside University Dictionary 291 (1st ed. 1988).

In *Mechanics Laundry & Supply, Inc. v. Indiana Dep't of State Revenue*, 650 N.E.2d 1223 (Ind. Tax Ct. 1995), the taxpayer who rented clean textiles claimed that it was entitled to an exemption for its purchases of EPA compliance items (waste water treatment equipment) pursuant to IC § 6-2.5-5-30. As a general rule to interpret the Indiana tax statutes, the Tax Court in *Mechanics Laundry* stated:

Where words are used at one place in an Act, they will be construed as used in the same sense at other places in the Act, unless the clear context of the statute requires a different meaning. Further, when considering two or more statutes that relate to the same general subject matter, the court will read those statutes in pari materia and construe them together so as to produce a harmonious system.

The environmental quality exemption is part of the same act in which the equipment, consumption, and incorporation exemptions are found. In addition, the language of the environmental quality exemption is nearly identical to the language used in the equipment, consumption, and incorporation exemptions.... The environmental quality exemption must, therefore, be construed in harmony with the equipment, consumption, and incorporation exemptions. Accordingly, the term "processing," as it is used in the environmental quality exemption, has meaning only to the extent that goods or items of other tangible personal property are produced. *Mechanics Laundry*, 650 N.E.2d at 1232. (Internal citations omitted).

The court in *Mechanics Laundry* found that both the taxpayer and the Department stipulated that the taxpayer is "engaged in the production or manufacture of logos and name tags." *Id.* Based on the evidence presented, however, the court in *Mechanics Laundry* determined that the taxpayer operated "its waste water treatment equipment in connection with the laundering of soiled textiles, but not in connection with the production of logos and names tags." *Id.* Thus, the court in *Mechanics Laundry* concluded that the taxpayer, *Mechanics Laundry & Supply, Inc.*, "is not entitled to receive the exemption for its purchases of EPA compliance items." *Id.*

In this instance, similar to the taxpayer in *Mechanics Laundry*, Taxpayer offers direct mail or fulfillment services which are not related to its manufacturing production. Taxpayer did not provide any documentation, demonstrating that it used the items at issue in connection with its printing production. Rather, Taxpayer simply asserted that "the filters are required to comply with federal and state environmental quality standards," and that "per law, [it] is only allowed to emit a certain level of toluene into the atmosphere," referring to page 17 of the "Compliance and Pollution Prevention Guidebook for Indiana Printers ("Guidebook")." Specifically, Taxpayer relied on page 17 of the Guidebook, listing "toluene" is one of "Hazardous Air Pollutants," but the Guidebook does not mandate that Taxpayer must use the item at issue to be in compliance with certain environmental statute, regulation, or standard. Thus, Taxpayer failed to provide any specific environmental statute, regulation, or standard, which it was required to comply with in connection with its printing production. Given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden. Since Taxpayer did not pay sales tax at the time of the purchase, use tax is properly imposed.

C. Taxpayer's Claimed Public Transportation Exemption.

The Department's audit assessed use tax on Taxpayer's purchases (leases) of trailers and repair/replacement parts because Taxpayer did not pay sales tax at the time of the purchases, nor did it self-assess and remit the use tax. Taxpayer protested the use tax assessments, claiming that its use of the trailers were exempt under the public transportation exemption pursuant to the Department's Sales Tax Information Bulletin 12 (December 2002), 26 Ind. Reg. 913, which was applicable for the Years at Issue.

The public transportation exemption is found at IC § 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

[45 IAC 2.2-5-61](#), in relevant part, further elaborates on the public transportation exemption:

(a) The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property.

(b) Definition: Public Transportation. **Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation** by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; **however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation unless it is in fact engaged in the transportation of persons or property for consideration as defined above.**

(c) In order to qualify for exemption, the tangible personal property must be reasonably necessary to the rendering of public transportation. The tangible personal property must be indispensable and essential in directly transporting persons or property. **(Emphasis added).**

Sales Tax Information Bulletin 12 (December 2002), in pertinent part, also states:

I. Public Transportation Definition

"Public transportation" means the movement, transportation or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities and other specialized carriers performing public transportation service for compensation by highway, rail, air or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the appropriate federal or state regulatory authority.

Even if a person or company operates under the appropriate authority, they also must transport people or property for consideration. That is to say, a public transportation provider must be compensated for transporting people or goods. The goods transported must be goods owned by someone other than the public transportation provider. To qualify for the exemption, a taxpayer must be predominately engaged in public transportation. A taxpayer is predominately engaged in public transportation if greater than 50 [percent] of its gross income is derived from transporting people or property for hire. **(Emphasis in original).**

Sales Tax Information Bulletin 12 (December 2002).

In *Panhandle Eastern Pipeline Co. v. Indiana Dep't. of State Revenue*, 741 N.E.2d 816 (Ind. Tax Ct. 2001), the court addressed the issue whether a taxpayer qualifies for the public transportation exemption. The court stated:

The public transportation exemption provided by section 6-2.5-5-27 is an all-or-nothing exemption. If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption. *Id.* at 819.

Four years later, in *Carnahan Grain, Inc. v. Indiana Dep't of State Revenue*, 828 N.E.2d 465 (Ind. Tax Ct. 2005), the court further explained the proper application of *Panhandle Eastern Pipeline*, as follows:

If [] the property is used predominantly for third-party public transportation, then the taxpayer is entitled to the exemption. Conversely, if the property is not predominantly used for third-party public transportation (i.e., it is predominantly used to transport the taxpayer's own property), then the taxpayer is not entitled to the exemption. *Id.* at 468.

In this instance, Taxpayer claimed that it was entitled to public transportation exemption because its affiliate company "is a common carrier for hire and moves print products for us as well as other companies. Pursuant to Information Bulletin [] 12, tangible personal property used directly in public transaction is exempt from sales tax."

Taxpayer is mistaken. First, based on its own statement, Taxpayer clearly is not the person or entity engaged in "public transportation" within the above-mentioned statutory and regulatory definition. Taxpayer is reminded that a statute which provides a tax exemption is strictly construed against the taxpayer. *RCA Corp.*, 310 N.E.2d at 97. "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101. Taxpayer did not submit any documentation showing

that it was the person or entity claimed to be engaged in "public transportation" within the statutory and regulatory definition. Thus, Taxpayer did not meet its burden. Since Taxpayer failed to demonstrate that it was the person or entity engaged in "public transportation," the Department is not required to examine whether Taxpayer predominantly used the items at issue for third-party public transportation. In short, Taxpayer's protest is denied.

D. Taxpayer's Claimed Purchases for Improvement of Realty.

The Department's audit assessed use tax on several transactions, including motors and electrical items. Taxpayer, to the contrary, claimed that its purchases were exempt pursuant to [45 IAC 2.2-3-7](#) and [45 IAC 2.2-3-8](#). [45 IAC 2.2-3-7](#) states:

(a) Contractors. For purposes of this regulation [\[45 IAC 2.2\]](#) "contractor" means any person engaged in converting construction material into realty. The term "contractor" refers to general or prime contractors, subcontractors, and specialty contractors, including but not limited to persons engaged in building, cement work, carpentry, plumbing, heating, electrical work, roofing, wrecking, excavating, plastering, tile and road construction.

(b) Construction material. For purposes of this regulation [\[45 IAC 2.2\]](#), "construction material" means any tangible personal property to be used for incorporation in or improvement of a facility or structure constituting or becoming part of the land on which such facility or structure is situated.

(c) Machinery, tools, equipment and supplies used by a contractor to perform a construction contract are not construction materials.

[45 IAC 2.2-3-8](#) provides:

(a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. **The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.**

(b) **All construction material purchased by a contractor is taxable** either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition **unless the ultimate recipient could have purchased it exempt** (see 6-2.5-5 [\[45 IAC 2.2-5\]](#)). **(Emphasis added).**

Upon reviewing Taxpayer's documentation, Taxpayer's reliance on the above provisions is misplaced. As discussed in Part A. 1, Taxpayer submitted "comparable" invoices which were not the underlying source documentation of the specifically selected transactions within the audit projection. Thus, in the absence of the invoices for the specifically selected transactions, its "comparable" invoices alone are not sufficient to support its assertion that its purchases were exempt.

Also, Taxpayer did not provide any documentation showing that it engaged in converting construction material into realty. [45 IAC 2.2-3-8\(a\)](#) states that "all sales of tangible personal property are taxable." Unless Taxpayer can demonstrate that its use of the tangible personal property was exempt, "[t]he conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property." Since Taxpayer did not pay sales tax at the time of its purchases, use tax is properly imposed.

E. Taxpayer's Claimed Purchase of a Service.

Taxpayer claimed that the Department's audit erroneously assessed use tax on its purchase of "recertification," which was a service. Taxpayer argued that service is "[e]xempt pursuant to [45 IAC 2.2-4-2](#)." [45 IAC 2.2-4-2](#) states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge; and
- (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of

this section], the gross retail tax shall not apply to such transaction.

Upon reviewing Taxpayer's documentation, the Department is not able to agree. Taxpayer's invoice states that it purchased "1 [] Recertification" of "Model[]," which was shipped by "carrier... UPS." Its invoice clearly demonstrates that Taxpayer purchased tangible personal property which was subject to sales/use tax. Given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden.

FINDING

Taxpayer's protest of part A. 2 is sustained. However, Taxpayer's remaining protest is respectfully denied.

Posted: 10/31/2012 by Legislative Services Agency

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